IN THE HIGH COURT OF GUJARAT AT AHMEDABAD

O.J.APPEAL No 12 of 2000

in

COMPANY APPLICATION No 52 of 2000

For Approval and Signature:

Hon'ble MR.JUSTICE R.K.ABICHANDANI Sd/-
and
Hon'ble MR.JUSTICE D.H.WAGHELA Sd/-

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1. Whether Reporters of Local Papers may be allowed to see the judgements? : YES
   YES

2. To be referred to the Reporter or not? NO :

3. Whether Their Lordships wish to see the fair copy of the judgement? : NO
   NO

4. Whether this case involves a substantial question of law as to the interpretation of the Constitution of India, 1950 of any Order made thereunder? : NO
   NO

5. Whether it is to be circulated to the Civil Judge? : NO
   NO

BANK OF TOKYO - MITSUBISHI LTD

Versus

ESSAR STEEL LIMITED

Appearance:

MR KI SHAH for Petitioner

MR KS NANAVATI for Respondent No. 1

CORAM : MR.JUSTICE R.K.ABICHANDANI
and
MR.JUSTICE D.H.WAGHELA

Date of decision: 13/03/2000

ORAL JUDGEMENT (Per R.K.Abichandani, J.)

The appellant - Bank challenges the order dated 2nd March, 2000 of the learned Company Judge in Company Application No.52 of 2000 filed in Company Petition No.42 of 2000 by which the respondent - original applicant was permitted under Section 536 (2) of the Companies Act, 1956, to deal with its Pellet Division by transferring some assets in favour of Higrade Pellets Ltd.

2. The principal debtor - Essar Power Ltd. was indebted to the appellant - Bank and the respondent has stood as a guarantor. The winding up petition has been filed by the appellant against the respondent on the ground that it did not fulfil its liability though the principal debtor had failed to repay its dues.

3. An application for permission under Section 536 (2) of the said Act was made by the respondent on the ground that, with a view to overcome its financial difficulties, it was trying to restructure its financial position and, for that purpose, it had decided to transfer its Pellet Division to a company, namely, Higrade Pellets Ltd. In the application it was pointed out that the respondent company was incorporated for manufacturing of high quality steel for which it had set up a huge industrial complex at Hazira, Surat for manufacture of high quality steel and steel products which are used in automobile industries, heavy industries, railways and for manufacture of gas cylinders etc. According to the respondent - applicant, its growth had been phenomenal and it had a turn over of Rs.2,500 crores per year. The reserves and surplus of the company were to the tune of Rs.2,414.18 crores as on March 1998 and its fixed assets were worth Rs.5,753.30 crores as on March 30, 1998. The net current assets of the company was worth Rs.1,300.21 crores as on March 1998. The profit before interest depreciation and tax of the company at the year ending March 31, 1998 was to the tune of Rs.726.19 crores. Its gross profit was increased by 34% to Rs.759 crores as on March 31, 1998. According to the respondent applicant, this is very clear from the 22nd Annual Report annexed at Annexure-I to the application. The company has engaged about 2000 workers. It is stated in para 3 of the application that the Government of Gujarat has given "Pioneer Unit Status" to the company for its steel project at Hazira. However, it was facing liquidity crunch on account of adverse market conditions. There were financial difficulties suffered by the respondent as in case of other steel industries

due to adverse market conditions. It is stated that sales of the company has however increased tremendously in the current year with a turn over of Rs.2,500 crores. It is stated that the company is in the process of re-engineering and restructuring its financial aspects and, by the approval of the members of the company under Section 293 of the Act by passing Resolution dated 24.9.1996, the company had resolved to transfer its assets and the effect to that Resolution was given from 31.3.1999 whereby the pellet plant of the company at Vishakhapattanam was transferred in favour of its associate company Higrade Pellets Ltd. According to the respondent company, it had furnished to the appellant a collateral guarantee in favour of the principal debtor Essar Power Ltd. and that Essar Power Ltd. had not denied this liability and had submitted its proposal for repayment to the appellant. The respondent therefore sought permission for disposal of its assets situate at Vishakhapattanam in favour of Higrade Pellets Ltd.

4. The learned counsel appearing for the appellant argued that the transaction in respect of which permission was sought under Section 536 (2) of the Act was not a bona fide transaction, because entries were effected in the books only with effect from 31st March, 1999 after receiving the statutory notice given by the appellant to the respondent. It was argued that the immoveable property could not be transferred by making an entry in the books of account. It was also contended that no details were given as to the nature of the transfer which was being effected. The learned counsel argued that the transfer of the assets was not made by inviting any public offers which would have reflected the true worth of the assets. Moreover, there was no data to show valuation of the assets. It was contended that while granting the validating order, the learned Company Judge has not considered the aspect of proper protection of unsecured creditors whose right to recover the amount by realizing the assets was being permanently destroyed. It was contended that the value of the assets proposed to be transferred was not taken into consideration by the learned Company Judge and that the effect of totality of circumstances shows that there was no justification for granting permission under Section 536 (2) of the Act. It was also contended that the decision to transfer the assets was mala fide and was taken because the respondent company was facing liquidity crisis since 1994. It was also argued that even by realizing the amount by transferring the assets, the respondent was not in a position to resolve its entire financial crisis. The learned counsel relied upon the decision of the Supreme

Court in the case of NAVALKHA & SONS v. SRI RAMANYA DAS reported in AIR 1970 SC 2037 in which the Supreme Court in para 6 of the judgment held that, unless the Court is satisfied about the adequacy of the price, the act of confirmation of the sale would not be a proper exercise of judicial discretion. That was a case in which the Supreme Court was concerned with Rule 273 of the Companies (Court) Rules, 1959 in respect of sale of the company's property. Under Rule 273, all sales were required to be made by public auction or by inviting sealed tenders or in any such manner as the Judge may direct. It is in this context that the Supreme Court observed that prejudice was inherent in the method adopted inasmuch as there was no publicity and the auction through public was confined to only two persons and therefore in those circumstances, the learned Judge ought not to have confirmed the bid offered in such an auction. The ratio of this judgment can have no application to the present case which falls under Section 536 (2) of the Act and there is no question involving sale of property by public auction.

The learned counsel for the appellant also referred to the decision of this Court in D.C.PATEL v. O.L. OF SURAT DAIRY CO. LTD. reported in 40 (1) G.L.R. 373 in which, in context of the provisions of Sections 448, 457, and 536 (2) it was observed that a person in whose favour there was merely an agreement to purchase property cannot claim a preferential right to purchase the property and that an auction sale was the best guide as to what price the property shall fetch and that the right of the Official Liquidator cannot be curtailed. It was held that disposition of property could not have been undertaken by the Official Liquidator by excluding the provisions of Section 536 (2) of the Act. In that case it was proved as a positive fact before the Court that the price estimated by the valuer was wholly inadequate and that nearly half times of the price assessed by the valuer was being offered by more than one applicants. It was held that it cannot be said that the agreement to sell, which was made in 1981, had created any interest in the property of the company so far as the appellants were concerned and, if at all the appellants were interested in the property of the company, they had to compete in open market along with other applicants. It was held that to give recognition to such preferential right would mean to recognize preferential right which had no sanction of law and such a course would operate to the prejudice in the matters of discharge of obligations of the company at the stage when the company was already being wound up. The court in the process referred to the

statement of law in BUTTERWORTHS 1991 Company Cases 468 that validation orders are only made in respect of the companies where the court is satisfied by credible evidence as to one or other of two factual conclusions and that the court must be satisfied that particular transaction (usually the sale of substantial asset) is beneficial to creditors, because it produced an advantageous price or some such benefit which are likely to be profitable and therefore will increase the company's assets to be beneficial to the creditors. It is thus clear that the court was concerned with a claim put forth on the basis of a sale agreement on the ground that the appellants had a pre-existing right to purchase the land in question and therefore they were entitled to get the land at the rate stated in the agreement to sell. Thus, looking to the background in which the decision was taken in the aforesaid case, it can have no application to the present case.

5. Admittedly, the appellant has filed an application under Section 19 of the Recovery of Debts due to Banks & Financial Institutions Act, 1993 before the Debts Recovery Tribunal at Ahmedabad against the respondent as well as the principal debtor. The liability of the respondent is alleged on the basis of some guarantee for the dishonour of which the appellant has filed a winding up petition. It is stated that the petition is not yet admitted and only notice has been issued. In the proceedings filed before the Tribunal, the appellant has prayed for a decree against the principal debtor and the present respondent No.2, who is the defendant No.2, for the sum of Rs.50,41,22,108.78 ps. being the amount due to the appellant in respect of the letter of credit facility granted to the principal debtor. A declaration is also sought for repayment of the dues, which amount is secured by a hypothecation created by the agreement for hypothecation dated 29.1.1996. A relief is sought for selling the hypothecated goods which are enumerated in Exhibit-M to the said application for realizing the dues. A recovery certificate is sought for the amount claimed for recovery of the dues by the Recovery Officer attached to the Tribunal. The appellant has prayed for interim relief restraining the principal debtor as well as the present respondent No.2 from selling, alienating, transferring, assigning, mortgaging etc. all or any of their assets including immovable properties described in Exhibit-N to the application and also including the hypothecated goods described in the Agreement of Hypothecation. Admittedly, an interim order was made on 21.7.1999 by the Presiding Officer of the Tribunal while issuing notice which was

made returnable on 11.8.1999, and status quo was ordered to be maintained by the present respondent with regard to the property described in Exhibit-N to the application which, it is stated, is the property at Hazira Steel Plant of the respondent No.2. It is stated that thereafter no further hearing has taken place before the Tribunal and the earlier order continues. Therefore, the question of interim relief is still at large before the Tribunal. The appellant has pursued the statutory remedy available to it under the law and has been granted interim relief by way of status quo as regards the immovable properties of the appellant which were described in Exhibit-N to that application and which are said to be the lands situate at Hazira.

6. The contention that the transfer which is sought to be made of the assets of the respondents which are at Vishakhapattanam is with a view to defeat the claims of the creditors and that it is a mala fide transfer, does not, prima facie, appear to be correct. Though the book entries are said to have been made on 31st March, 1999, there is a clear evidence to show that the Resolution to transfer the business of the company's pellet plant and liabilities attributable to the plant was made at the Twentieth Annual General Meeting of the respondent company held on 24th September, 1996. That Resolution reads as under:

"Certified true extract from the minutes of the Twentieth Annual General Meeting of Essar Steel Limited held on September 24, 1996.

TRANSFER OF PELLET PLANT.

RESOLVED THAT pursuant to Section 293 (1) (a) and other applicable provisions, if any, of the Companies Act, 1956, and subject to such other approvals as may be required, the consent of the Company be and it is hereby accorded to transfer the business of the Company's Pellet Plant and liabilities attributable to the Plant to a subsidiary company to be formed as a going concern on such terms and conditions as the Board of Directors of the Company may deem fit.

RESOLVED FURTHER THAT the Board of Directors of the Company be and they are hereby authorised to do and delegate all such acts, deeds, matters and things as they may, in their absolute discretion, deem necessary or desirable, to a Committee of Directors, to give effect to this resolution."

It would thus appear that the decision to transfer the business of the company's pellet plant was taken long before the guarantee given by the respondent No.2 was invoked by the appellant. Therefore, that decision could not have been made with a view to defraud the appellant or to defeat its claim. Moreover, the learned Company Judge has taken into account the financial condition of the respondent company which is disclosed in its application and has exercised judicial discretion for granting permission under Section 536 (2) of the Act in respect of the proposed transfer by holding that the intention behind selling the Pellet Division was to raise funds for effective and efficient working of the respondent company. Under sub-section (2) of section 536 of the Act, in the case of winding up by or subject to the supervision of the Court, any disposition of the property of the company and transfer of its shares or alteration in the status of its members, made after the commencement of the winding up, shall, unless the Court otherwise orders, be void. In view of the provisions of Section 441 (2), the winding up of a company by the Court shall be deemed to commence at the time of the presentation of the petition for the winding up. It is obvious that immovable properties could not have been transferred by making entries in the books of account and the necessary registered conveyance deeds were required to be executed. It is for this reason that the permission was required by the respondent under Section 536 (2), without which no transfer of immovable property could have been treated as valid. The approval of transfer saves the transfer from being treated as void under the said section. The expression "unless the Court otherwise orders" in sub-section (2) of section 536 casts a duty on the Judge to examine as to whether the dealing in question was being entered into in good faith and with honest intention. The idea behind conferring judicial discretion on the Company Judge is to ensure that a company is not unduly hampered from carrying out transactions which are beneficial to the running of the company, and that no such permission should be granted if the transaction is intended to defraud the creditors. The decision to transfer the business of the company's pellet plant is in context of forming a subsidiary company which was found to be necessary for restructuring its business. That decision taken nearly two-and-half years prior to filing of the winding up petition and nearly two years before the issuance of notice of demand to the respondent No.2 could not be said to have been taken with a view to defeat the claim of the appellant or to defraud the creditors. Therefore, the learned Company

Judge was right in holding that the proposed transaction was not intended to defraud the creditors and that granting of permission under Section 536 (2) was warranted in this case. In this view of the matter, there is no substance in this appeal and it is summarily dismissed.

7. At this stage, the earned counsel for the appellant prays for staying the order of the learned Company Judge. There is no warrant for issuing such stay order and the request is rejected.

(KMG Thilake)
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